INDEX

CITATIONS

762676—47

In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 356

PEDRO SANCHEZ, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Tax Court (R. 4–17) is reported at 6 T. C. 1141. The opinion of the Circuit Court of Appeals (R. 57–59) is reported at 162 F. 2d 58.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on June 21, 1947. (R. 60.) The petition for a writ of certiorari was filed on September 19, 1947. The jurisdiction of this Court rests on Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

The taxpayer, a nonresident alien, is the owner of certain domestic and foreign patents to which he granted exclusive world-wide rights to a licensee. He was entitled to a portion of the sales price received by his licensee, a domestic corporation, which manufactured and sold the patented product in the United States. In instances where the product was to be used abroad, the licensee gave the purchasers royalty-fee sublicenses to use the product and the process in foreign countries under taxpayer's foreign patents.

Was the court below correct in concluding that the income received by the taxpayer from his American licensee was, regardless of where the product was ultimately used by the purchasers, income from within the United States and taxable to the taxpayer under Sections 211 (b) and 212 (a) of the Internal Revenue Code?

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.
>
> (a) *Gross income from sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:
>
> * * * * *
>
> (4) *Rentals and royalties.*—Rentals or royalties from property located in the

United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using in the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like property; and

* * * * *

(c) *Gross income from sources without United States.*—The following items of gross income shall be treated as income from sources without the United States:

* * * * *

(4) Rentals or royalties from property located without the United States or from any interest in such property, including rentals or royalties for the use of or for the privilege of using without the United States, patents, copyrights, secret processes and formulas, good will, trade-marks, trade brands, franchises, and other like properties; and

* * * * *

(26 U. S. C. 1940 ed., Sec. 119.)

SEC. 211. TAX ON NONRESIDENT ALIEN INDIVIDUALS.

* * * * *

(b) *United States business or office.*—A nonresident alien individual engaged in trade or business in the United States or having an office or place of business therein shall be taxable without regard to the provisions of subsection (a). * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 211.)

SEC. 212. GROSS INCOME.

(a) *General rule.*—In the case of a nonresident alien individual gross income includes only the gross income from sources within the United States.

* * * * *

(26 U. S. C. 1940 ed., Sec. 212.)

STATEMENT

The taxpayer, a resident of Havana, Cuba, was a nonresident alien during the taxable year of 1940. He is the inventor of a certain process for treating and clarifying sugar solutions, and of an improved chemical re-agent, called Sucro-Blanc, which is used in that process. The taxpayer secured patents both in the United States and in certain foreign countries covering these inventions. (R. 5–6.)

In 1934, the taxpayer granted the full and exclusive world-wide rights to employ these patents to a licensee. (R. 6.) On July 1, 1936, by virtue of an agreement between all of the parties this license was assigned to Sucro-Blanc, Inc., a New York corporation, from whom the taxpayer became entitled to receive certain payments which, as modified by a subsequent agreement made on September 18, 1937, consisted of 10 percent of the price received by the licensee on all sales of the chemical, Sucro-Blanc, made by it. The taxpayer was also entitled to receive

37½ percent of the proceeds realized by the licensee from any sale, assignment, sublicense, or other disposition of any of the patents or patent rights. (R. 7–8.)

In June 1940, another agreement was entered into by the parties which purported to clarify their previous agreements. It characterized the moneys payable to the taxpayer as constituting royalties and stated that the method of computing such royalties was merely a gauge in determining how much of the consideration was based on royalties for the granting of the exclusive license under the foreign patents and how much for the license under the United States patents. In addition, Sucro-Blanc, Inc., was required by the agreement to keep and maintain records showing the sales made by virtue of the exclusive license granted under foreign patents and those under the exclusive license granted under the United States patents. (R. 8.)

The licensee manufactured the chemical in the United States and all sales by it occurred in this country. Some of the sales were made to customers who utilized the product in the United States. Other sales were made to purchasers who utilized the product in foreign countries; the amount paid to the taxpayer by the licensee with respect to the latter sales was $8,673.30, the item of income in dispute in this case. (R. 8.) In all cases where the chemical was used outside

the United States, the licensee made no charge to the purchasers for the privilege of their utilizing the product or the process in the foreign countries under the foreign patents and, instead, gave them a royalty free sub-license. (R. 9–10.) The Tax Court held that all of the income paid to the taxpayer by his licensee on its sales of the chemical, regardless of where utilized by the purchasers, was income derived from sources within the United States and was taxable in its entirety to the taxpayer. (R. 11–15.) The Circuit Court of Appeals upheld the Tax Court's determination. (R. 57–59.)

ARGUMENT

1. The decision below is correct. The taxpayer's petition is formulated entirely on the supposition that the income in question consisted of royalties paid to him for the use of certain foreign patents. (Br. 7–10.) This is a clear misconception of the facts which were found by the Tax Court, on the basis of which both it and the Circuit Court of Appeals determined the case. The taxpayer is an inventor of a process for clarifying sugar solutions and also of a chemical product which is utilized in the process. He owns the domestic and certain foreign patents relating to the process as well as to the product. (R. 5–6.) The taxpayer granted the exclusive, world-wide rights under his patents to a licensee, a domestic corporation, and, during the taxable year, was

entitled to receive from his licensee royalties equal to 10 percent of the price received by it on its sales of the product and also royalties equal to 37½ percent of all sums received by the licensee from any sale, assignment, sublicense or other disposition of the patents made by it. (R. 6–8.) The licensee manufactured the chemical product in the United States and all sales of the product were made by it in this country. (R. 8–10.) While some of the purchasers shipped the chemical to foreign countries for utilization there, they were never required to pay any royalties to the licensee on account of the taxpayer's foreign product and process patents; instead, in all instances those purchasers were granted the right to utilize the foreign patents royalty free. (R. 10.) As a result, the only income received by the taxpayer from his licensee consisted of royalties based on the manufacture and sale of the product within the United States; he never became entitled to receive any payments from the licensee on account of his foreign patents since the licensee never exacted any royalties for their utilization. In these circumstances, the taxpayer is clearly mistaken in asserting that, whenever the chemical was utilized abroad by the purchasers, he received royalties under his foreign patents which would constitute income from sources outside the United States under Section 119 (c) (4) of the Internal Revenue Code, *supra*. Since no charges were

made for the use of the foreign patents, the taxpayer never received any income from them. And, since the only payments which the licensee made to the taxpayer were based on its manufacture and sale of the product in the United States, his royalties arose only under his United States patents,[1] and those royalties, being classified as gross income from within the United States by Section 119 (a) (4) of the Internal Revenue Code, *supra,* are made taxable to a nonresident alien under Sections 211 (b) and 212 (a) of the Internal Revenue Code, *supra.*

2. The taxpayer is likewise mistaken in asserting (Br. 10) that this case raises a question concerning the proper interpretation of the taxing statute. The courts below did not deny that, if the taxpayer had received royalties on account of his foreign patents, such income would have been derived from sources without the United States and would not have been taxable to the taxpayer. The only question in this case was whether the taxpayer was correct in asserting that he did receive such royalties. This having been determined against him, and it is difficult to see how any other conclusion could have been reached

[1] *Extractol Process* v. *Hiram Walker & Sons*, 153 F. 2d 264 (C. C. A. 7th), and *Caterpillar Tractor Co.* v. *International Harvester Co.*, 106 F. 2d 769 (C. C. A. 9th), illustrate the fundamental principle that a manufacture or sale in this country of a patented article involves a necessary use of the United States patent.

on the basis of the undisputed facts, the application of the statutory provisions followed as a matter of course.

3. No conflict in decisions exists and none is asserted by the taxpayer. *Commissioner* v. *Piedras Negras B. Co.*, 127 F. 2d 260 (C. C. A. 5th), relied on by the taxpayer (Br. 9–10), did not involve royalties on domestic or foreign patents, and the decision there has no bearing on the question presented here.

CONCLUSION

The decision of the Circuit Court of Appeals is correct. There is no conflict in decisions; and no question of statutory interpretation is presented. Accordingly, further review is not warranted.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

HELEN R. CARLOSS,
GEORGE A. STINSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

OCTOBER 1947.

U. S. GOVERNMENT PRINTING OFFICE: 1947